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Shareholders' Value Creation in it Sector in India - A Comparative Study Between TCS & Infosys

KEYWORDS: Profitability, Du Pont analysis, ROE and Shareholder wealth maximization

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ABSTRACT *Equity shareholders are the one who sink and swim with the company. They always get the residual after meeting all expenses and other requirements. That's why; they are the real owners of the business. Hence, it is very necessary that the firm should try its best to maximize the wealth of the shareholder particularly equity shareholder. Therefore, the present article attempts to analyze the profitability performance of TCS and INFOSYS with regard to Shareholders' wealth maximization. Du Pont Analysis has been applied to study the performance of ROE. The basic objective of selecting these two companies is to understand and apply the concept of SWM in these companies with different factsheets. The study found that TCS has provided consistent return to the equity shareholders on their investment over Infosys.*

Introduction:
Information Technology (IT) industry in India is one of the fastest growing industries. Indian IT industry has built up valuable brand equity for itself in the global markets. IT industry in India comprises of software industry and information technology enabled services (ITES), which also includes business process outsourcing (BPO) industry. India is considered as a pioneer in software development and a favorite destination for IT-enabled services.

In the past, Indian economy was state-controlled and the state remained hostile to the software industry through the 1970s. Import tariffs were high (135% on hardware and 100% on software) and software was not considered an "industry", so that exporters were ineligible for bank finance. Government policy towards IT sector changed when Rajiv Gandhi became Prime Minister in 1984. His New Computer Policy (NCP-1984) consisted of a package of reduced import tariffs on hardware and software (reduced to 60%), recognition of software exports as a "delicensed industry", i.e., henceforth eligible for bank finance and freed from license-permit raj, permission for foreign firms to set up wholly-owned, export-dedicated units and a project to set up a chain of software parks that would offer infrastructure at below-market costs. These policies laid the foundation for the development of a world-class IT industry in India.

Today, Indian IT companies such as Tata Consultancy Services (TCS), Wipro, Infosys, HCL et al are renowned in the global market for their IT prowess.

Review Literature
Du Pont analysis, a common form of financial statement analysis, decomposes return on net operating assets into two multiplicative components: profit margin and asset turnover **(B. McClure).**

These two accounting ratios measure different constructs and, accordingly, have different properties. Prior research has found that a change in asset turnover is positively related to future changes in earnings **(M. Soliman)**

Du Pont analysis takes into account three indicators to measure firm profitability: ROA, ROE and ROI.

Return on Assets – **ROA** offers a different take on management effectiveness and reveals how much profit a company earns for every dollar of its assets (**[S. Ross, R. Westerfield, J. Jaffe, B. Jordan).** Assets include things like cash in the bank, accounts receivable, property, equipment, inventory and furniture.

ROA = ***Total Assets / Net income***

Return on equity – **ROE** It is a basic test of how effectively a company's management uses investors' money – ROE shows whether management is growing the company's value at an acceptable rate. Also, it measures the rate of return that the firm earns on stockholder's equity. Because only the stockholder's equity appears in the denominator, the ratio is influenced directly by the amount of debt a firm is using to finance assets **(B. McClure).** Practically, ROE reflects the profitability of the firm by measuring the investors` return **(J. J. Griffin, J.F. Mahon).**

ROE = Stockholder's equity/Total Assets X Total Assets/ Net income X Stockholder s equity / Total Assets
ROE is calculated by taking the profit after tax and preference dividends of a given year and dividing it by the book value of equity (ordinary shares) at the beginning of the year. Average equity can also be used. Equity would consist of issued ordinary share capital plus the share premium and reserves **[J.H.V.H. de Wet, E. du Toit].**

Return on Investment – ROI The return on investment is the return earned from the investment made by the firm. This gives the actual position of the firm. ROI shows whether the management is in profitable position or not. It measures the earnings of the firm. It multiplies profit margin and Asset Turnover**. (B. McClure)**

ROI = Assets Turnover (Operating Income X Total Assets) X Profit Margin (EBIT X Operating Income)
Saunders (2000) provides a model of financial analysis for financial institutions based on the DuPont system of financial analysis return on equity model and return on investment model. The return on equity model disaggregates performance into three components: net profit margin, total asset turnover, and the equity multiplier. The profit margin allows the financial analyst to evaluate the income statement and the components of the income statement. Total asset turnover allows the financial analyst to evaluate the left-hand side of the balance sheet: assets. The equity multiplier allows the financial analyst to evaluate the right-hand side of the balance sheet: liabilities and owners equity

Dr Ahmed Arif Almazari (2012) This study attempts basically to measure the financial performance of the Jordanian Arab commercial bank for the period 2001-2009 by using the DuPont system of financial analysis which is based on analysis

Volume : 3 | Issue : 11 | Nov 2013 | ISSN - 2249-555X

of return on equity model and return on investment model. It was found that the financial performance of Arab Bank is relatively steady and reflects minimal volatility in the return on equity. Net profit margin and total asset turnover exhibit relative stability for the period from 2001 to 2009.The equity multiplier also show almost stable indicators for the period from2001-2005 and the ratios declined from 2006-2009 which indicates that the Arab bank had less financial leverage in the recent years, which means the bank is relying less on debt to finance its assets.

Research Design and Methodology
Sample Design:

This research considered the top IT companies in the IT sector such as Infosys and TCS.

Objectives of the Study:

- To know the profitability performance of selected IT companies
- To know which IT firm has created more shareholder value during the study period.

Period of the Study:
The period of the study is 5 years starting from 2008-09 to 2012-13.

Data used:
For the purpose of this study, the main data used is secondary in nature. The data have been collected from the annual reports of the selected sample companies' financial statements.

Tools and Techniques used:
The main technique used for the study is Du Pont Analysis. It has been well supplemented by ratio analysis, trend analysis.

Table 1 Profitability Analysis- TCS (Figures in %)

Period	2012-13	2011-10	2010-11	2009-10	2008-09
Operating Profit Margin	28.72	28.48	29.53	27.06	22.11
Net profit Margin	22.09	21.30	24.30	22.86	18.90
ROCE	34.61	33.69	43.82	43.63	45.26
RONW	36.01	35.21	37.01	37.91	33.48
Reported EPS (Rs.)	70.99	53.07	46.27	35.67	53.63

Source: Compiled from the annual reports of the company

Table 2 Profitability Analysis- Infosys (Figures in %)

Period	2012-13	2011-10	2010-11	2009-10	2008-09
Operating Profit Margin	29.96	32.19	33.15	34.82	34.08
Net profit Margin	24.61	25.55	25.38	27.22	28.72
ROCE	37.3	40.87	37.58	37.25	42.9
RONW	26.15	28.00	27.90	28.22	33.82
Reported EPS (Rs.)	157.55	139.05	112.26	100.37	101.65

Source: Compiled from the annual reports of the company

Table 3 Du Pont Analysis- TCS

Period	2012-13	2011-12	2010-11	2009-10	2008-09
EBIT/Net Assets	0.35	0.34	0.44	0.44	0.45
PAT/EBIT	0.77	0.75	0.82	0.84	0.85
Net Assets/ Net worth	1.35	1.40	1.03	1.03	0.87
ROE (PAT/ NW)	0.36	0.35	0.37	0.38	0.33

Source: Compiled from the annual reports of the company

Table 4: Du Pont Analysis- Infosys

Period	2012-13	2011-12	2010-11	2009-10	2008-09
EBIT/Net Assets	0.27	0.30	0.31	0.35	0.40
PAT/EBIT	0.82	0.78	0.76	0.79	0.83
Net Assets/ Net worth	1.19	1.20	1.18	1.01	1.00
ROE (PAT/ NW)	0.26	0.28	0.28	0.28	0.34

Source: Compiled from the annual reports of the company

Results and Discussion: (TCS)
After analyzing the performance of TCS over the study period, it was found that the operating profit ratio has been in the increasing trend because of good operating performance shown by the company and it could able to post good growth rate in the operating profit in spite of global meltdown in 2008. The steady growth in terms of operating profit is primarily due to increase in sales revenue and efficient control of operating expenses (increase in the no. of clients over the study period).

The net profit ratio was only 18.9% in 2008-09 FY; however it has improved dramatically in the rest of the study period. In 2010-11, it was at 24.10% and 22% in 2012-13 FY. From this numbers, we could say that the net profit ratio was also showing an upward trend due to relatively higher increase in operating profit and the total revenue.

The ROCE of the firm was in the decreasing trend over the study period. The ROCE was 45.26 % in the 2008-09 FY, however it has reduced to 34.61% which means that the company could not able to sustain good return on its capital employed. Though there was an inferior performance in the ROCE, the company could able to post good RONW. From the table, it is clear that the RONW was 33.48 % and it has increased to 37.91% in 2009-10. Finally, we can say that the company has succeeded in providing good returns to the equity shareholders over the study period.

Infosys:
After analyzing the five year performance of Infosys, it is found that the operating and net profit margins were in the decreasing trend due to relative increase in operating expenses being more than that in sales. The operating profit margin was 34.08% in FY 2008-09, but it was reduced to 29.66% in FY 2012-13 which indicates that the company failed in maintaining consistent performance in terms of operating profit and net profit over the study period.

ROCE and RONW were also in the decreasing trend due to less profitability posted by the firm. The ROCE was high in the FY 2008-09 however it has come down to 37.3 % in the FY 2012-13. Even in posting good RONW also, the company miserable failed due to low operating efficiency. However the company has reported higher EPS (increasing trend) over the study period.

Du Pont Analysis:
As observed from the table 3, the ROE for TCS is supported primarily by the leverage factor which has been in increasing trend over the study period. This has supported the increase in the ROE. The company's PAT/EBIT has deteriorated, while the (Net assets / Net worth) has increased over the study period. The combined effect however, has been favorable; The ROE has increased from 33% in FY 2008-09 to 36%. Thus the in terms of assets utilization, the company has done a good job, but profitability point of view it has not performed up to mark.

Table 4 depicts that, the ROE for Infosys was in the decreasing trend, it was 34 % in 2008-09 and fallen to 26% in 2012-13. The leverage factor has been supporting the ROE over

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the study period. The company's PAT/EBIT has fallen dramatically, while the (Net assets / Net worth) has increased over the study period. The combined effect however, has been unfavorable in terms of ROE.

Conclusion:
From the study it is concluded that, TCS has shown good performance with regard to SWM, primarily from the efficiency of borrowed funds and assets utilization to ROE. However Infosys has shown inferior performance than TCS in providing reasonable ROE to the equity shareholders on their investment.

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